

**DEPARTMENT OF STATE REVENUE  
LETTER OF FINDINGS NUMBER: 99-0062  
Sales and Use Tax  
For the Tax Period 1995-1997**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

**ISSUES**

**1. Sales and Use Tax- Imposition of Use Tax on Grating**

**Authority:** IC 6-8.1-5-1 (b), IC 6-2.5-3-2 (a), IC 6-2.5-5-2-IC 6-2.5-5-3 (b), 45 IAC 2.2-5-10(c), *Gross Income Tax Division v. National Bank and Trust Co.*, 79 N.E. 2d 651 (Ind. 1948), *Indiana Department of Revenue v. American Dairy of Evansville, Inc.*, 338 N.E. 2d 698, (Ind. App. 1975), *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983).

The taxpayer protests the assessment of use tax on grating.

**2. Sales and Use Tax-Imposition of Use Tax on Applied Air System**

**Authority:** IC 6-2.5-3-2 (a), IC 6-2.5-5-3 (b), 45 IAC 2.2-5-8(c), 45 IAC 2.2-5-8(g).

The taxpayer protests the imposition of use tax on an applied air system.

**3. Sales and Use Tax-Imposition of Use Tax on Scale**

**Authority:** IC 6-2.5-5-3 (b), 45 IAC 2.2-5-10(d),

The taxpayer protests the imposition of use tax on a scale.

**4. Sales and Use Tax-Refund Items**

**Authority:** IC 6-2.5-3-2(a), IC 6-8.1-9-1(a), IC 6-8.1-5-4.

The taxpayer protests the disallowance of certain refund claims.

**5. Sales and Use Tax-Imposition of Use Tax on Decals**

**Authority:** IC 6-2.5-3-2 (a), IC 6-2.5-5-27,

The taxpayer protests the assessment of use tax on decals.

**6. Sales and Use Tax-Imposition of Use Tax on Exhaust and Wall Fans.**

**Authority:** IC 6-2.5-3-2(a), IC 6-2.5-5-3(b), 45 IAC 2.2-5-8(c)(4)(B).

The taxpayer protests the imposition of use tax on exhaust and wall fans.

**7. Sales and Use Tax-Imposition of Use Tax on Equipment Purchased from Reeder Heating**

**Authority:** IC 6-2.5-3-2 (a), IC 6-2.5-5-3 (b).

The taxpayer protests the assessment of use tax on an item purchased from Reeder Heating.

**8. Tax Administration-Imposition of Penalty**

**Authority:** IC 6-8.1-10-2.1, 45 IAC 15-11-2(b).

The taxpayer protests the imposition of the ten percent (10%) negligence penalty.

**STATEMENT OF FACTS**

The taxpayer is a corporation that processes food products. After an audit for the tax period 1995-1997, the Indiana Department of Revenue, hereinafter referred to as the “department,” assessed additional use tax, interest, and penalty. The taxpayer agreed with some of the assessed items and protested the remainder of the assessment. A hearing was held and this Letter of Findings results.

**1. Sales and Use Tax- Imposition of Use Tax on Grating**

**DISCUSSION**

All tax assessments are presumed to be accurate. The taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b).

Indiana imposes an excise tax, the use tax, on tangible personal property purchased in a retail transaction and stored, used, or consumed in Indiana if sales tax was not paid at the time of purchase. IC 6-2.5-3-2 (a). In *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983) the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-10 (c) further describes manufacturing machinery and tools as exempt if they have an immediate effect on the property in production.

There are a number of exemptions from the use tax pursuant to the statute. All exemptions must be strictly construed against the party claiming the exemption. *Gross Income Tax Division v. National Bank and Trust Co.*, 79 N.E. 2d 651 (Ind. 1948).

The taxpayer contends that many items, including the bar grating, qualify for exemption pursuant to one of two statutory provisions. First, the items qualify pursuant to the following provisions of IC 6-2.5-5-2 (a):

Transactions involving agricultural machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use in the direct production, extraction, harvesting, or processing of agricultural commodities.

The taxpayer argues that the items could also qualify for exemption pursuant to the following provisions of IC 6-2.5-5-3 (b):

Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining; or finishing of other tangible personal property.

Both exemptions share the basic elements that the item must be “directly used in direct production”. Therefore, the Indiana Court of Appeals found in *Indiana Department of Revenue v. American Dairy of Evansville, Inc.*, 338 N.E. 2d 698, (Ind. App. 1975) that the court cases and interpretations of the manufacturing exemption also apply to the agricultural production exemption.

The taxpayer’s first protest concern’s the department’s assessment of use tax on bar grating that is part of the foundation of the tomato dock. The taxpayer contends that this bar grating is part of the exempt equipment used to unload and clean the fresh tomatoes. The bar grating does not, however, have an immediate effect upon the processing of the tomatoes. It would be possible to clean the tomatoes without the bar grating. Rather, the bar grating allows superfluous water, dirt, and cleaning agents to leave the cleaning area. This use does not qualify the bar grating for exemption from the use tax.

### **FINDING**

The taxpayer’s protest to the assessment of use tax on the bar grating is denied.

## **2. Sales and Use Tax-Imposition of Use Tax on Applied Air System**

### **DISCUSSION**

The taxpayer also protests the imposition of use tax on an applied air system pursuant to IC 6-2.5-3-2 (a). The taxpayer contends that this system is directly used in the direct production of its product and qualifies for exemption found at IC 6-2.5-5-3 (b).

This air system is used to maintain the temperature in a storage area where cans of product are stored. The taxpayer contends that the air system is necessary to preserve the integrity of the product. Approximately sixty per cent (60%) of the cans stored in the area with the subject air system are unlabeled. If the temperature were to drop too low in the storage area, water would condense on the unlabeled cans, causing the cans to rust. The taxpayer claims that it can not sell rusted cans.

The taxpayer's product is tomatoes and tomato products. The taxpayer packages those products in cans. For the air system to qualify for exemption it must be directly used in the direct production of the tomato products. Pursuant to 45 IAC 2.2-5-8(c) it must have "an immediate effect on the article being produced." This requirement is further described at 45 IAC 2.2-5-8(g), which states:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. . . . The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not in itself mean that the property "has an immediate effect upon the article being produced:.. Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

The air system is not functionally interrelated with the processing of tomatoes and tomato products. The air system affects the cans, the packaging of the taxpayer's product rather than the product itself. Anything done to affect the cans is done outside the direct production process of producing tomato products. Since the air system affects the cans rather than the tomato products, it is not directly used in the direct production of tomato products. The air system does not qualify for exemption.

### **FINDING**

The taxpayer's protest is denied.

### **3. Sales and Use Tax-Imposition of Use Tax on Scale**

### **DISCUSSION**

The taxpayer also protests the assessment of use tax pursuant to IC 6-2.5-3-2 (a) on a scale that weighs the produce prior to the cleaning of the tomatoes. Immediately after arriving at the processing facility, the truck loaded with tomatoes drives onto this scale to be weighed. Then the weight of the truck is deducted from the total weight to determine the weight of tomatoes in that delivery. The taxpayer argues that the scale is directly used in the direct production of tomato products and therefore qualifies for exemption from the use tax pursuant to the directly used in direct production manufacturing exemption found at IC 6-2.5-5-3 (b)

To qualify for this exemption, the scale must be used during the production process. The standard for determining the parameters of the direct production process are found at 45 IAC 2.2-5-10(d), which states:

Pre-processing and post-processing activities. "Direct use" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the processing or refining has altered the item to its completed form, including packaging, if required.

(1) The production of pharmaceutical items is accomplished by a process which begins with weighing and measuring out appropriate ingredients, continues with combining and otherwise treating the ingredients, and ends with packaging the items. Equipment used to transport raw materials to the manufacturing plant is employed prior to the first operation or activity constituting part of the integrated production process and is taxable. Weighing and measuring equipment and all equipment used as essential and integral part of the subsequent manufacturing steps, through packaging, qualify for exemption.

The taxpayer contends that it uses the subject scale in the same exempt manner as the scale in the example. The department disagrees with the taxpayer's comparison of the subject scale and the scale in the example. The scale in the example combines weighing and measuring in one step, the first step of the production process. Therefore, the use of the scale in the example is integral and essential to the process of manufacturing pharmaceuticals. The taxpayer's scale is not used for specific and precise measurements of ingredients in the taxpayer's production process. It is not an integrated system to weigh and measure. Rather, the subject scale is used to weigh all the tomatoes in the truck prior to the first step in the production process, the cleaning of the tomatoes. The scale does not measure the tomatoes other than determining the gross weight. The taxpayer's use of the scale is more analogous to a scale to weigh the total amount of a chemical raw material at the time of its delivery to the plant prior to the precise weighing and measuring which starts the process of producing pharmaceuticals. A scale used at a pharmaceutical company in the same manner as the taxpayer's scale is used would also be taxable.

### **FINDING**

The taxpayer's protest to the tax assessed on the scale is denied.

#### **4. Sales and Use Tax-Refund Items**

### **DISCUSSION**

Pursuant to IC 6-8.1-9-1(a), the taxpayer claimed refunds of use taxes paid on several items. The taxpayer also contended that it presented several items such as pest control and boiler parts to the department for exemption that were not found to be exempt in the final assessment. The taxpayer filed two separate and frequently overlapping refund claims for the same years as the audit. The taxpayer also had one employee make the original use tax accrual decision and then, in the numerous cases where the deciding employee's supervisor disagreed with the decision, the supervisor would claim a credit against the use tax accrual for a later month. Review of the taxpayer's records indicated that there were numerous items that were claimed more than once and several items where credit was claimed three times.

The taxpayer has the responsibility to keep adequate records to substantiate its claims pursuant to IC 6-8.1-5-4. The taxpayer was unable to offer adequate documentation to sustain its burden of proving that the refunds were improperly denied.

### **FINDING**

The taxpayer's protest is denied.

#### **5. Sales and Use Tax-Imposition of Use Tax on Decals**

### **DISCUSSION**

The taxpayer also protests the assessment of use tax on decals applied to trucks owned by a related transportation company.

The decals are placed on the bodies of tractor-trailers belonging to the taxpayer's dedicated common carrier. The decals are colorful, conspicuous, and expensive. They contain pictures, the taxpayer's name and the required common carrier number.

Pursuant to IC 6-2.5-3-2 (a), the use of the decals is subject to use tax unless the use qualifies for a statutory exemption. The taxpayer contends that the use of these decals qualifies for exemption pursuant to the following provisions of IC 6-2.5-5-27:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

The taxpayer ordered these decals. The invoices indicate that the decals were billed to the taxpayer. The taxpayer's books and records indicate that the taxpayer paid for the decals and charged them to advertising expense. The journal entry indicating that the related transportation corporation later reimbursed the taxpayer for the purchase of the decals does not change the reality that the actual transaction was between the taxpayer and seller of the decals. The taxpayer purchased the decals without paying sales tax on the transaction. The taxpayer used the decals by placing them on the related corporation's trucks and benefited from the advertising and deliveries. The taxpayer did not use or consume the decals in the providing of public transportation for its products. Whether or not the related corporation could purchase the decals exempt is irrelevant. The taxpayer and the related corporation enjoy many benefits by being separate corporations. They must also assume the liabilities associated with being separate corporations. The taxpayer's use of the decals does not qualify for the public transportation exemption.

### **FINDING**

The taxpayer's protest is denied.

#### **6. Sales and Use Tax-Imposition of Use Tax on Exhaust and Wall Fans.**

### **DISCUSSION**

The taxpayer also protests the department's assessment of use tax on exhaust and wall fans pursuant to IC 6-2.5-3-2(a). The taxpayer contends that these exhaust and wall fans qualify for the directly used in direct production exemption pursuant to IC 6-2.5-5-3(b).

The exhaust and wall fans are used in various areas where the processing of the product causes significant heat. The taxpayer contends that OSHA requires the fans and the employees could not work without them. Therefore, they qualify for exemption as essential and integral to the production process.

The department disagrees. Pursuant to 45 IAC 2.2-5-8(c)(4)(B), the department has consistently denied the exemption of exhaust and wall fans since they are used for the employees' comfort and well being. They are not integral and essential to the production process.

The taxpayer also protests that one imposition of use tax was actually on a service fee paid to the installer of the fan. Pursuant to the provisions of IC 6-2.5-3-2(a) the use tax is only imposed on the use of tangible personal property, not services except in certain specifically defined instances. The invoice stated that the cost was for "mark-up" on the cost of the equipment. That "mark-up" is part of the fan's price. The use tax is computed on the price of the tangible personal property sold. The taxpayer failed to prove that the imposition was actually on a service associated with installing the fan rather than the cost of the fan. Therefore, the disputed amount of the "mark-up" is taxable.

### **FINDING**

The taxpayer's protest is denied.

## **7. Sales and Use Tax-Imposition of Use Tax on Air Conditioning System**

### **DISCUSSION**

Pursuant to IC 6-2.5-3-2(a), the department assessed use tax on an air conditioning system. The taxpayer contends that this equipment acted as an air filtration system that qualified for the directly used in direct production equipment exemption pursuant to IC 6-2.5-5-3(b).

The equipment was installed in the area where catsup is put into clear plastic bottles. The temperature in this area is not high enough to kill germs. Therefore, the taxpayer argued that it needed to install the air conditioning system to create a clean, aseptic environment to filter out contaminating particles and bacteria.

The taxpayer did not provide sufficient documentation to substantiate its claim that the catsup bottling area was a clean room with all air flowing in and out through the subject air system. Although the system may retard the growth of bacteria, there was no evidence that it meets the standards of an air filtration system for a clean room. The air conditioning system provides for the comfort and well being of the employees. It is subject to the use tax.

### **FINDING**

The taxpayer's protest is denied.

## **8. Tax Administration-Imposition of Penalty**

### **DISCUSSION**

The taxpayer protests the imposition of the ten percent (10%) negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

During the tax period, the taxpayer purchased without paying the sales or use tax on many clearly taxable items such as magazine subscriptions, filing cabinets, books, business cards, and office supplies. These breaches of the taxpayer's duty constitute negligence.

### **FINDING**

The taxpayer's protest is denied.

KMA/JMM/JMS--052804